



Oklahoma Economic Report™

News and analysis of Oklahoma's economy

A publication of the Office of the State Treasurer • Treasurer Ken Miller, Ph.D.

Merited return on investment

It's classic economic theory. In fact, Adam Smith, the father of capitalism, wrote extensively on the topic more than 200 years ago, and it is at the core of economics in today's society. Workers, the theory holds, respond to financial incentives.

Government employees, on the other hand, have traditionally been compensated strictly through below-market hourly or salaried pay with above-market benefits. Performance – good, bad or in between – usually does little to change pay or benefits.

But must it be that way? What if public

sector employees were given financial incentives to increase their output? Could a win-win scenario be created that monetarily benefits the state employees and the people of Oklahoma?

Setting the stage

Enter the Oklahoma State Treasurer's Unclaimed Property Division. As one of the first consumer protection programs in the nation, state government unclaimed property programs reunite citizens with lost property – primarily money – that businesses owe to them.

After businesses lose track of the

owners, state law requires they turn over the money or other valuable items to the state. That way, instead of businesses retaining billions in forgotten deposits, overpayments, royalties, rebates, stocks, bonds, unpaid wages and safe deposit box contents, the state can help reunite the owners with their property. In cases where the owners can not be found, the money can be used for the public good.

Created in 1967 and housed at the Oklahoma Tax Commission, the program was transferred to the Office of the State Treasurer in fiscal year

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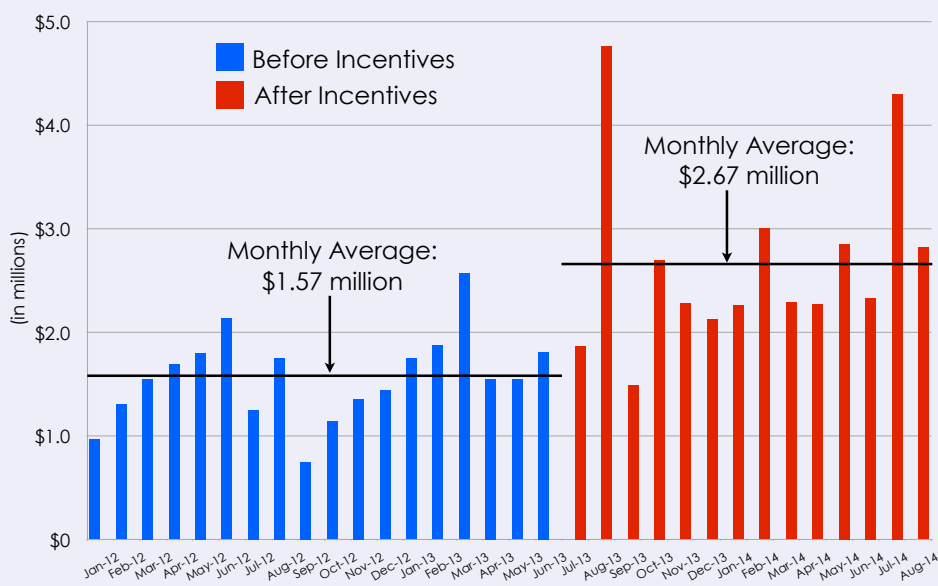
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Oklahoma Unclaimed Property - Monthly Returns



Source: Office of the State Treasurer, Internal Auditor



Treasurer's Commentary

By Ken Miller, Ph.D.

The matter of incentives

"It is not the benevolence of the butcher, brewer or baker that we expect our dinner, but from their regard to their own self-interest, we address ourselves not to their humanity, but to their self-love, and never speak to them of our own necessities, but their own advantage."

These are the words Adam Smith penned in the *Wealth of Nations* to explain the theory of free market capitalism and his invisible hand doctrine. The statement uses an example from daily life to show how rational self-interest propels a functioning market economy. But more importantly, the words eloquently explain one underlying free market principle that would change the future of nations and people forevermore. Incentives matter.

This centuries old tenet of capitalism became the basis on which the Oklahoma Treasury would remake its unclaimed property division into a results-oriented team. With a clearly defined objective of returning more money to its rightful owners, senior treasury staff crafted and implemented a first-in-the-nation incentive pay pilot program for unclaimed property staff; more money returned will mean more money earned.

The risks of failure and criticism were evident. Coming off of back-to-back records for Oklahoma unclaimed property reunification, it was possible the treasury could not improve efficiency and results. Morale could suffer as some may be unable to adapt to a merit system. And opponents could try to spin "wasteful" employee pay increases, even if the pilot proved successful. Time would tell if the bet on private sector principles would pay off in the public sector.

“Even in the public sector, meaningful incentives that encourage individual achievement can benefit the common good.”

Knowing only a positive return on investment could suffice in the court of public opinion, the management team anxiously awaited the internal auditor's monthly cash settlement announcements.



Even though the pilot program was to last the full fiscal year, the jury was out only a few months when it became clear the \$18.8 million record from the previous year would be shattered. Amazingly, by fiscal year end the amount of unclaimed property returned totaled \$30 million, far surpassing expectations.

The bet paid off for both citizens and employees. Money returned increased over 60 percent and money earned increased by 11 percent, for a positive return on investment of more than 15,000 percent! Proof that even in the public sector, meaningful incentives that encourage individual achievement can benefit the common good.

Today, the unclaimed property division of the treasury has a new Capitol home, an enhanced marketing campaign, and an innovative compensation program, all designed

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Commentary

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to meet our objective of getting more money back into the hands of rightful owners.

I could not be more proud of the

unclaimed property team of dedicated men and women who dutifully serve the people of Oklahoma. While much of the discussion surrounding unclaimed property every year centers on how much of the fund

government can spend, we at the state treasury are excited our successful initiative is putting more money into the hands of rightful owners and making a difference in the lives of many Oklahomans and our economy.

Incentives

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2000. During its final year at the tax commission, the division reunited Oklahomans with \$5.3 million.

In subsequent years, the amount returned increased substantially due to numerous efforts to increase productivity, including upgrading software, additional marketing and outreach, and posting of the unclaimed property database on the internet. Annual returns more than tripled during the next 14 years, but the growth rate eventually slowed to an average of less than 10 percent per year.

Outside the box

The scene: A senior staff meeting around a conference table strewn with spreadsheets in the office of State Treasurer Ken Miller in early 2013. At the table, the treasurer, his top deputies and the unclaimed property program director.

The issue: After years of doing the same thing the same way, what, if anything, could be done differently to get more unclaimed property back in the hands of its rightful owners?

The discussion was wide-ranging and included talk of fine-tuning a fast track return option that permits paperless claims approval for owners with verifiable addresses and low dollar amounts, the possibility of hiring more people to process claims, and the option of revamping the entire claims process from start to finish.

Each option was weighed for its potential costs and benefits.

Admittedly, up to this point all the ideas were contained well within the box of typical government processes. That was until the economist treasurer said, “A basic tenet of economics is that people respond to incentives. So why not officer a merit pay system?”

It became a Eureka! moment. The others paused, contemplating the concept, and agreed, somewhat skeptically, it just might be possible and it just might work.

Long practiced in the private sector with indisputably positive results, perhaps in at least this one area of the public sector similar results could be achieved.

Pilot program

As outlined in the June 2013 edition of the *Oklahoma Economic Report*, a first-in-the-nation pilot program was developed following that senior staff meeting and put into practice in July 2013, the start of FY-14.

During FY-13, the year before the pilot program was launched, returns of cash and stock totaled \$18.8

million – an all time record high and increase of about six percent from the year before. But FY-14, with its pay for performance plan, left that and every other year in the dust.

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“At year’s end, Oklahomans received more than \$30.2 million in unclaimed property – an increase from the prior year of \$11.4 million or 61 percent.”



Incentives

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With clearly defined group and individual goals established, the pilot program offered employees in the unclaimed property division the opportunity to receive quarterly and annual financial incentive payments in return for increasing the amount of money returned to Oklahomans.

“**The incentive program’s return on investment is an astounding 15,260 percent.**”

The treasurer originally suggested a first-year goal of increasing cash returns by 55 percent, but after hearing senior management express serious concerns at meeting such a lofty goal, he relented to a more reasonable goal of increasing cash payouts by 30 percent.

It was an ambitious goal, but initial results were strong. In the first month, returns increased by almost 50 percent from the same month of the prior year. The second month brought all-time record returns of almost \$4.8 million, a jump of 172 percent from August 2012.

At year’s end, Oklahomans received more than \$30.2 million in unclaimed property – an increase from the prior year of \$11.4 million or 61 percent.

Comparing the results to the performance in other state unclaimed property programs is difficult. There is no uniform reporting by the states to match against other states’ performances. However, a survey conducted by the treasurer’s internal auditor could find no other state with a higher one-year performance increase.

The unprecedented results of the pilot program have drawn the attention of other treasurers.

Earlier this year, a presentation on Oklahoma’s program and its results was received with much interest at a meeting of the National Association of State Treasurers with many states asking for additional details afterwards.

Strong ROI

Comparing the \$74,710 increase in payroll costs from FY-13 to FY-14 to the \$11.4 million increase in unclaimed property payments yields a return on investment of 15,260 percent.

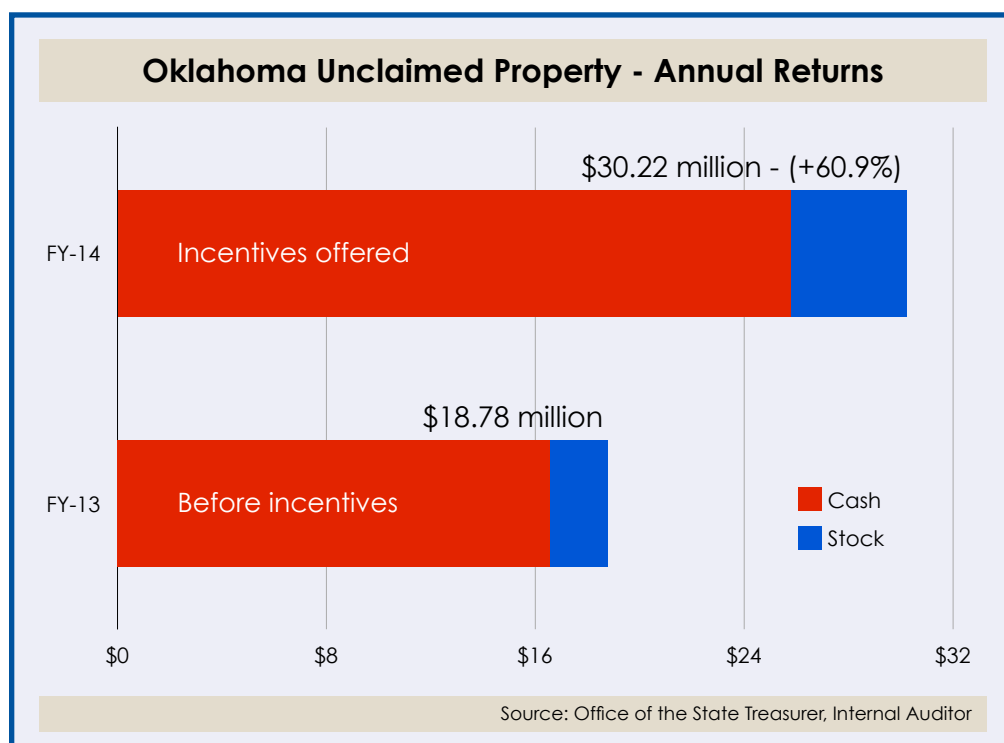
In real numbers, 16 staff members received an average of \$4,225 in pay-for-performance compensation, but gave up an average of \$2,791 in overtime pay. Incentive payments amounted to \$67,593, while eliminating overtime saved \$44,657, netting a difference of \$22,936.

All of this comes at no cost to taxpayers. Operation of the unclaimed property division is funded entirely from the unclaimed property remitted to the state by businesses and is limited to four percent of the money received. The budget for the pay-for-performance program still maintains operational costs well below the four percent maximum allowed.

New normal

Though skeptical at first, the agency’s

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Incentives

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chief deputy and unclaimed property director fully embraced the new mission, created a solid program and championed it.

Adjustments were made along the way. The incentive program includes minimum performance standards upon which regular pay is based. Most of the staff responded well, but a few were unable to transition to the new paradigm and personnel changes became necessary.

What remains is a vibrant, more efficient staff that is results and outcomes oriented.

The positive results of the one-year pilot program made the decision easy on whether to make it permanent. For FY-15, the goal has been raised to \$35 million.

After two months under the new goals in the current fiscal year, the results are even stronger than at the start of last year. Returns for July and August of 2014 total \$7.12 million, up \$490,000 or 7.45 percent, keeping in mind that returns in August of last year set an all-time one-month record.

The bottom line is that more Oklahomans are getting more of their lost property returned to them due to a small investment with huge returns, and all done without growing government.

The increase in returns also means the Legislature, which over the years has grown increasingly dependent on taking excess unclaimed property funds out of the program for use in the budget, might have to curtail its appetite.

Each year, the program provides \$10 million to be spent in the state budget. The reason is that, in spite of all the

efforts to reunite Oklahomans with their lost money, some of them will never be found, and limited funds, presumed to be recurring, can most appropriately be used for a public purpose.

But for the past several years, the Legislature has found ways to spend even more of the money – taking \$220 million in the past six years, including \$44.5 million for the current budget.

As the pay-for-performance program matures, lawmakers could come calling for more funds in future years and find the cupboard is bare because the money has been returned to its rightful owners.

While recognizing the potential for criticism for paying state employees more, the treasurer believes that if the Legislature can take almost \$45 million in a single year to spend on the government, spending less than \$68,000 for incentives to help Oklahomans be reunited with their lost money is well worth the investment.

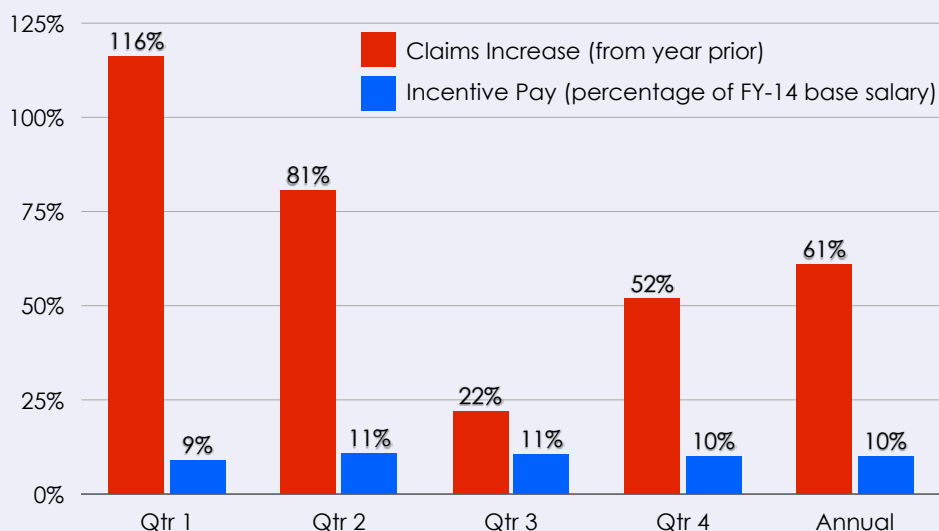
It's all the result of applying to the public sector classic economic theory that has worked throughout the years in the private sector.

A program that in its first year returned an additional \$11.4 million to Oklahomans through an investment of less than \$68,000 is proof that Adam Smith was right – people respond to incentives, regardless of where they work.

Find your lost money

Search for unclaimed property at www.yourmoney.ok.gov, where claims can also be initiated and progress monitored. Contact the division at unclaimed@treasurer.ok.gov.

FY-14 Unclaimed Property Claims vs Incentive Pay
Percentage Increase



Source: Office of the State Treasurer, Internal Auditor



Gross Receipts & General Revenue compared

The Treasurer's August 6 Gross Receipts to the Treasury report and the Office of Management and Enterprise Services' August 12 General Revenue Fund (GRF) report contain several differences.

July gross receipts totaled \$992.22 million, while the GRF received \$471 million or 47.5% of the total.

The GRF received between 33.1% and 57.1% of monthly gross receipts during the past 12 months.

From July gross receipts, the GRF received:

- Personal income tax: 71.2%
- Corporate income tax: 50%
- Sales tax: 45.7%
- Gross production-Gas: 41.2%
- Gross production-Oil: None
- Motor vehicle tax: 26.9%
- Other sources: 33%

July GRF allocations finished ahead of the estimate by \$69.6 million or 17.3%. Collections were also higher than the prior year by \$61.2 million or 14.9%.

For July, insurance premium taxes totaled \$1.58 million.

Tribal gaming fees generated \$10.25 million during the month.

July Gross Receipts to the Treasury show marked improvement

Gross Receipts to the Treasury in July were the highest of any July in Oklahoma history, providing another indication of the state's expanding economy, State Treasurer Ken Miller announced at a State Capitol news conference.

The healthy performance of the Oklahoma economy in July pushed 12-month collections further into record territory, as has been the case for 12 of the past 13 months.

Growth in monthly collections from personal income and corporate income taxes was especially robust, accounting for more than 50 percent of the increase in July.

July collections topped \$992 million, while 12-month collections are now just shy of \$11.8 billion.

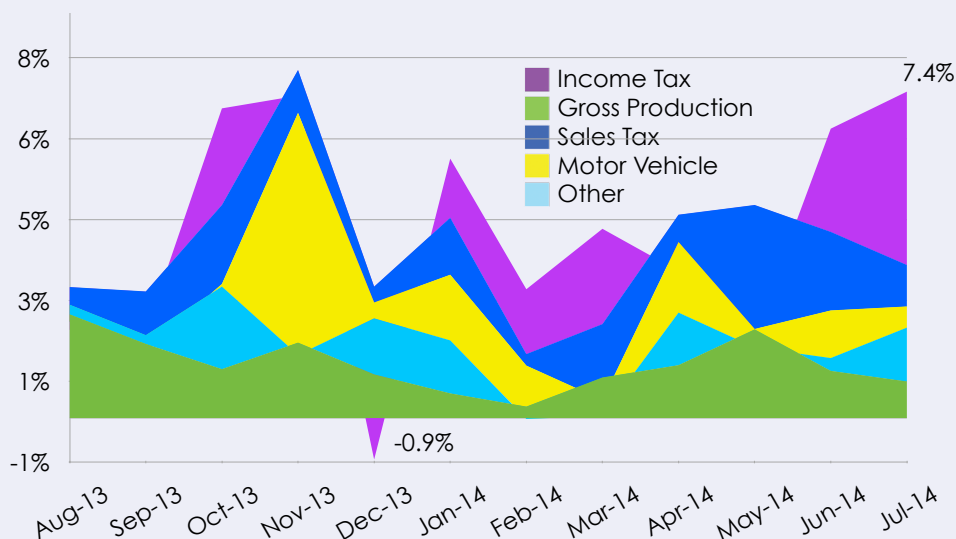
"Gross Receipts to the Treasury, which provide a broad look at the state's economic performance, show year-over-year growth in all but six months during the past four and a half years," Miller said. "With apologies to Rodgers and Hammerstein, we're still doing fine, Oklahoma."

Twelve-month gross receipts hit a trough in February 2010 of \$9.4 billion.

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“With apologies to Rodgers and Hammerstein, we’re still doing fine, Oklahoma.”

Monthly Gross Receipts vs. Prior Year
August 2013 – July 2014



Percentage change from prior year

Source: Office of the State Treasurer



Oklahoma unemployment at 4.6 percent in July

Oklahoma's seasonally-adjusted unemployment rate was listed at 4.6 percent in July by the Oklahoma Employment Security Commission, down one full percentage point from July of last year.

Compared to July 2013, statewide employment decreased by 15,800 jobs, while the number of those listed as jobless dropped by 18,890 people according to the preliminary, seasonally-adjusted figures. The labor force shrank by 34,690 over the 12-month period.

The national unemployment rate was set at 6.2 percent in July.

State Unemployment Report				
OKLAHOMA	Unemp. rate*	Labor force*	Employment*	Unemployment*
Jul '14	4.6%	1,783,280	1,700,960	82,320
Jun '14	4.5%	1,793,690	1,712,330	81,360
May '14	4.6%	1,807,070	1,724,170	82,910
Apr '14	4.6%	1,816,770	1,732,410	84,370
Mar '14	4.9%	1,823,900	1,734,290	89,610
Feb '14	5.0%	1,825,140	1,734,200	90,940
Jul '13	5.6%	1,817,970	1,716,760	101,210

* Data adjusted for seasonal factors

Source: OESC

Revenue

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Since then, collections have grown by more than \$2.4 billion, or 25 percent,

with monthly collections higher than the same month of the prior year in 46 of the past 52 months.

All major revenue categories

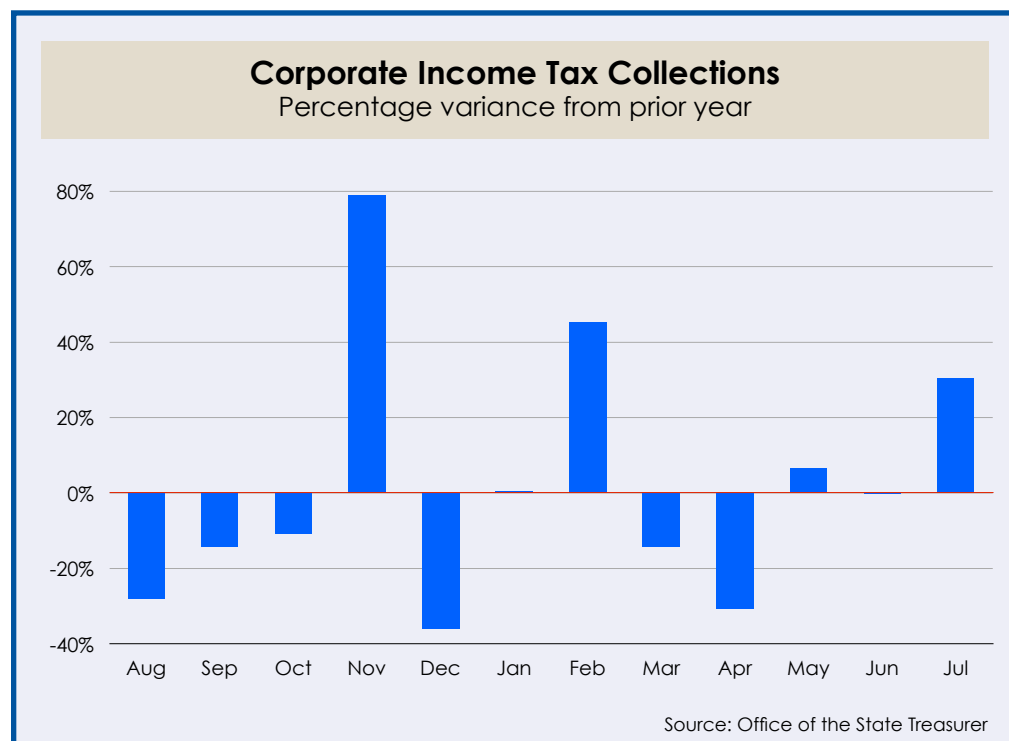
experienced growth in July, with total collections topping the prior year by 7.4 percent. Collections for the past 12 months are up by more than 4 percent.

Gross income tax collections and the state's tax on oil and natural gas production showed the largest gains at 13.4 percent and 11.1 percent, respectively.

About Gross Receipts to the Treasury

Since March 2011, the Treasurer's Office has issued the monthly Gross Receipts to the Treasury report, which provides a timely and broad view of the state's macro economy.

As announced by Governor Mary Fallin, it is released in conjunction with the General Revenue Fund allocation report from the Office of Management and Enterprise Services, which provides important information to state agencies for budgetary planning purposes.

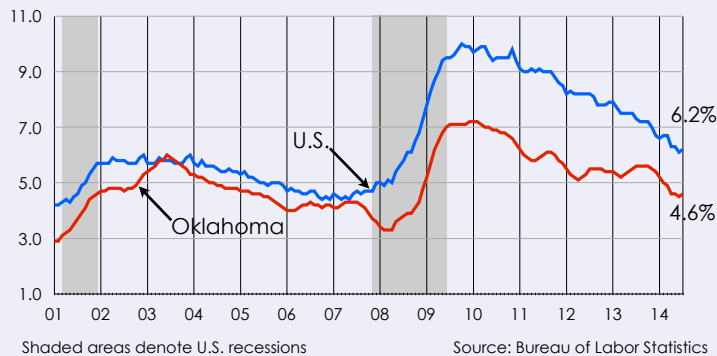




Economic Indicators

Unemployment Rate

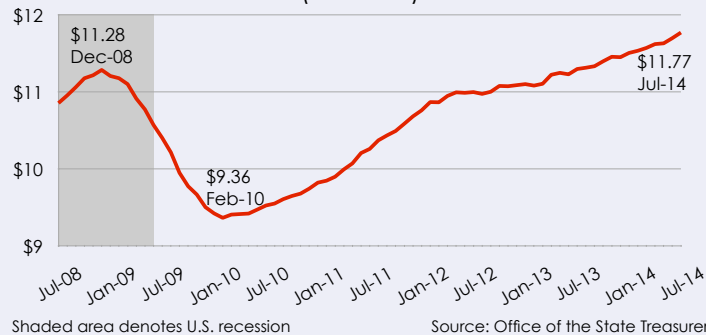
January 2001 – July 2014



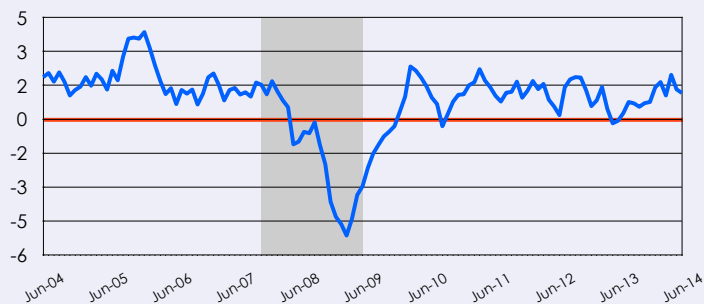
Oklahoma 12-Month Gross Receipts

July 2008 - July 2014

(in billions)



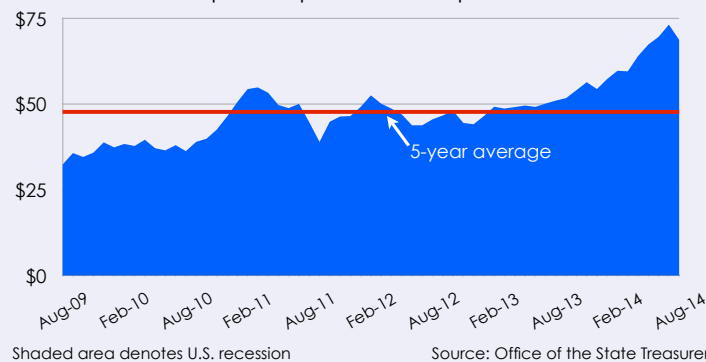
Leading Index for Oklahoma



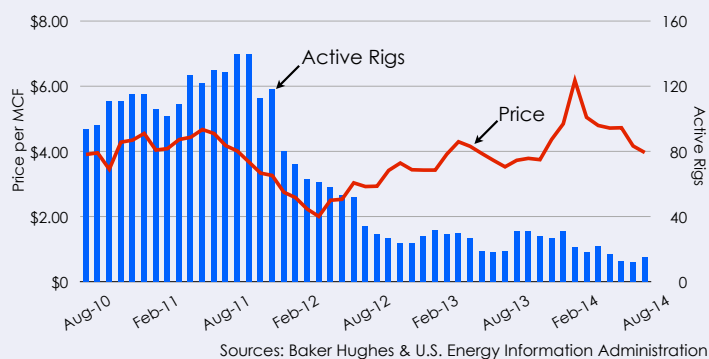
This graph predicts six-month growth by tracking leading indicators of the state economy including initial unemployment claims, interest rate spreads, manufacturing and earnings.

Oklahoma Stock Index

Top 25 capitalized companies



Oklahoma Natural Gas Prices & Active Rigs



Oklahoma Oil Prices & Active Rigs

